



April 18, 2022

Submitted by email to rule-comments@sec.gov

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. S7-02-22

Ladies and Gentlemen:

The Global Digital Asset & Cryptocurrency Association (“GDCA”) and others who have signed this letter welcome the opportunity to comment on SEC Release No. 34-94062, “Amendments to Exchange Act Rule 3b-16 Regarding the Definition of ‘Exchange’; Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSs That Trade U.S. Treasury Securities and Agency Securities” (collectively, the “Proposed Rules”), as published in the Federal Register on March 18, 2022 (the “Proposing Release”).¹

Introduction and Overview

The GDCA is a global self-regulatory association for the digital asset and cryptocurrency industry. We were established to guide the evolution of digital assets, cryptocurrencies, and the underlying blockchain technology within a regulatory framework designed to build public trust, foster market integrity and maximize economic opportunity for all participants. Our broad-based membership includes digital asset trading platforms, proprietary trading firms, institutional investors, fund managers, merchant banks, brokerage firms, miners, node operators, custodians, banks, law firms, auditing firms, insurance professionals, academics, consultants and others.

To fulfill our mission, we create standards and consensus-based solutions designed to address responsibly the major challenges facing the digital asset and cryptocurrency industry. In doing so, we collaborate with stakeholders around the world, including industry leaders, professionals, policymakers and regulators. In particular, we:

- advocate for a regulatory environment that allows innovation and protects consumers, stakeholders, and the broader public interest;
- provide education, training, certification, and other resources to build human and technical capacity;
- provide thought leadership and facilitate industry engagement; and

¹ See 87 Fed. Reg. 15496, available at <https://www.federalregister.gov/documents/2022/03/18/2022-01975/amendments-regarding-the-definition-of-exchange-and-alternative-trading-systems-atss-that-trade-us>.

- oversee our members through a self-regulatory mechanism that is guided by principles of accountability, integrity and transparency to promote the highest professional and ethical standards.

We are commenting upon the Proposing Release because of its significance to the digital asset industry and the public. In the Proposing Release, the Commission proposes to redefine the term “exchange” in Exchange Act Rule 3b-16 as applied to all securities. We have no comment on the Proposed Rules relative to Treasury securities or other fixed income securities. In line with our mission, we will comment on the Proposed Rules as they would purport to apply to “other securities” and, in particular, “investment contracts,” which are covered by the statutory definition of “security.” In particular, our comments will focus on the proposed redefinition of “exchange” to include “Communication Protocol Systems that make available for trading any type of security....”² Our comments respond to Questions 1, 2 and 3 to Part II of the Proposing Release.

As you will see, we believe that the process by which the Commission is seeking to expand its regulatory net around the digital asset industry is flawed because, among other things, it violates the administrative due process rights of participants in that industry. We also believe that the Proposing Release and the Proposed Rules offer a false choice to the digital assets industry because both proffered options — exchange registration and ATS qualification — are unworkable absent other rule changes and infrastructure development that are not proposed and have not been put into place.

The Commission’s haste to adopt the Proposed Rules — permitting a mere 30 days for comments — contrasts sharply with SEC inattention to, and even obstruction of, necessary digital asset infrastructure development. That contrast will harm investors if the Proposed Rules are adopted and applied to investment contracts because none of the SEC, the industry or the investing public is prepared for what we will call “investment contract exchange” registration or ATS qualification, owing to the absence of infrastructure, guidance and models. The Commission itself has impeded the development of those essentials, and the 591-page Proposing Release provides no relevant guidance.

For example, one of our members has had a digital asset custodial broker application pending with the SEC for four full years. Another member counseled a broker-dealer that was forced to put itself up for sale because it was running out of money, as SEC Staff and FINRA Staff well knew, during the two-year process that it endured before the Staffs finally approved the operation of its digital asset ATS on the eve of expiration of its continuing membership application. Many other pioneers, put on hold indefinitely, have simply abandoned their efforts and withdrawn their applications to conduct business as digital asset broker-dealers, ATSs, transfer agents, qualified custodians, and so forth.³ Digital asset industry

² Proposing Release, 87 Fed. Reg. at 15498. “Communication Protocol System” is defined by the Commission to “include a system that offers protocols and the use of non-firm trading interest to bring together buyers and sellers of securities.” Id. at 15497 note 5.

³ The Commission and its Staff have been slow and reluctant to address other compelling needs of the digital asset industry and the public it serves. Best-known in this regard is the treatment of bitcoin cash market exchange-traded product applications, which are invariably rejected despite overwhelming public demand (but only after drawn-out processes that often extend to the very limit of what the Commission’s rules allow). Another example is the reality that something like 10,000 pairs of crypto assets trade on public platforms, see <https://coinmarketcap.com>, while

participants have largely disengaged because — as Commissioner Peirce has often noted — the Commission and its Staff have created hurdles for this industry to overcome that are not required by law and are faced by no other industry.⁴ Because the Commission and its Staff slow-walk digital industry initiatives, and because in the end precious few are approved, the infrastructure — and the guidance — that would be required to bring even one “investment contract platform” online as an SEC-registered exchange or regulated ATS does not exist. There are no useful models for others to follow. Practically speaking, then, the proposed rules would function not as an industry regulation and oversight framework, but rather as a regulatory bar to the operation of broad swaths of digital assets business.

We believe, for reasons stated below, that it would be a considerable challenge for the Staff to approve even one investment contract platform as a registered exchange or qualified ATS. And, if birthing one such SEC-regulated platform might be too hard to execute (given all the missing pieces), then one can only imagine how difficult it would be for the Staff to process dozens of investment contract platform applications concurrently. Shoe-horning investment contract markets into the regulatory remit of SEC exchange and ATS regulation without first enabling the creation of critical infrastructure and the provision of helpful guidance would cause massive investment loss to retail investors in digital assets, for which the Commission would bear responsibility.

The Proposed Rules are a surprise to the digital assets industry and to digital assets investors and are contrary to the message of the President’s Executive Order on Digital Asset Regulation.

The Commission plainly contemplates applying its revised definition of “exchange” to “all securities,” without exception: “The definition of ‘exchange’ under Exchange Act Section 3(a)(1) and current Exchange Act Rule 3b-16(a) applies to all securities..., and does not exempt or exclude any security or type of securities.”⁵ This is so “notwithstanding how thinly traded or novel a security may be....”⁶ The laundry list of securities identified by the Commission in the Proposing Release does not even mention “investment contracts,” defined by *Howey*⁷ and its progeny. Referring to “all securities” nonetheless makes clear the Commission’s intention that digital assets that are investment contracts are within the scope of this sweeping rulemaking proceeding.

the Division of Corporation Finance has issued no-action advice that particular digital assets are not “securities” only three times, see TurnKey Jet, Inc. (Apr. 3, 2019), Pocketful of Quarters, Inc. (publicly available July 25, 2019) and IMVU Inc. (available Nov. 17, 2020). In 2022, core development teams see little reason to solicit no-action assurances from an SEC Staff with a penchant for imposing conditions on “relief” that have no basis in federal securities law. See, e.g., IMVU Inc., *supra* (conditioning no-action letter assurances upon applicant’s performance of KYC/AML checks, a requirement with no basis in federal securities law). See also Commissioner Hester M. Peirce, “How We Howey” (May 29, 2019): “I do not believe there was anything gray about the area in which TurnKey planned to operate, but issuing this letter may give the false impression that there was.”

⁴ See, e.g., Dissenting Statement of Hester M. Peirce in Response to Release No. 34-88284 (Feb. 26, 2020).

⁵ See Proposing Release, 87 Fed. Reg. at 15503.

⁶ *Ibid.*

⁷ *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). The list in the Proposing Release does include “equity securities that are not NMS stocks,” but many digital assets are not equity securities. See comment letter response of Blockstack Token LLC dated May 15, 2019, <https://sec.report/Document/0001104659-19-029829/>.

The proposed redefinition of “exchange” to cover digital assets trading interest banter is new. There has been no prior notice or opportunity to be heard on this topic. The Commission in the Proposing Release is deviating from the thoughtful approach that it followed when it first adopted Regulation ATS and its operative definition of “exchange.” Under that approach, which we commend, the Commission studied, published and weighed practices constituting brokerage and exchange functions as defining the range of activity that it was undertaking to regulate and as a predicate for delineating when brokerage behavior crossed the line into “exchange” behavior. The Commission then gave affected industry participants the choice to register as a broker-dealer that would operate an ATS or instead register as an exchange.

In his Executive Order on Ensuring Responsible Development of Digital Assets issued March 9, 2022 (the “Executive Order”), the President wrote that “The United States has an interest in responsible financial innovation” (Section 1); that the federal government “should promote the responsible development of digital assets” (Section 2(a)); and that “[w]e must reinforce United States leadership in the global financial system and in technological and economic competitiveness” (Section 2(d)). The President ordered numerous studies to be carried out and reported over the course of a year.

The message of the Executive Order is that federal agencies (including the SEC) are expected to study digital assets and thereafter make reasoned proposals: “The United States must maintain technological leadership in this rapidly growing space, supporting innovation while mitigating the risks for consumers, businesses, the broader financial system, and the climate.”⁸

The Department of Commerce — not the SEC — has been directed “to work across the U.S. Government in establishing a framework to drive U.S. competitiveness and leadership in, and leveraging of digital asset technologies. This framework will serve as a foundation for agencies and integrate this as a priority into their policy, research and development, and operational approaches to digital assets.”⁹

Even if the SEC takes the view that it need not comport with the purpose or thrust of the EO, which is its prerogative as an independent agency, doing so runs in direct contravention to the often forgotten “fourth pillar” of the SEC’s mission: competition.¹⁰ It is our view that not only should the SEC work within the thoughtful process that President Biden set forth, but should more stridently work to elevate competition within its rulemaking and regulatory agenda.

⁸ FACT SHEET: President Biden to Sign Executive Order on Ensuring Responsible Development of Digital Assets (March 9, 2022), at <https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/09/fact-sheet-president-biden-to-sign-executive-order-on-ensuring-responsible-innovation-in-digital-assets/>.

⁹ Ibid.

¹⁰ See comments delivered by SEC Commissioner Robert J. Jackson, Jr. to the Open Markets Institute and Village Capital on October 11, 2018. <https://www.sec.gov/news/speech/speech-jackson-101118>. In addition to the three long-standing elements of the SEC’s mission (investor protection, maintenance of fair and orderly markets, and facilitation of capital formation), Commissioner Jackson posited, as a fourth pillar of its mission, that the SEC should foster competitiveness in United States markets.

In its rush today to regulate “exchanges” (as redefined) serving purchasers and sellers of investment contracts, the Commission has failed to study those particular markets and the functions performed by the various classes of market participants and to explain the legal and practical consequences of its regulatory decisions. As a result, neither the Commission nor the industry knows what to expect. This is contrary to the message of the Executive Order and is inconsistent with the Commission’s tradition of careful study of the markets that it regulates, engagement with participants in those markets while formulating possible rules, consideration of the secondary effects of its proposed rules, and thoughtful guidance to affected market participants in advance of adopting new rules.

As explained next, the process underway is so flawed that adopting the Proposed Rules as a next step, without exempting the digital asset industry, would be unlawful.

The Proposed Rules suffer from serious procedural defects as applied to the digital assets industry. Any attempt to apply the Proposed Rules to the industry without curing the defects would violate the administrative due process rights of industry participants.

As the Commission recognizes, Exchange Act Section 3(f) requires the Commission to evaluate whether the Proposed Rules will promote efficiency, competition and capital formation.¹¹ The Commission purports in the Proposing Release to include a section that “analyzes the expected economic effects of the proposed rules relative to the current baseline, which consists of the current market and regulatory framework in existence today.”¹² This analysis stems from the Commission’s “statutory obligation to determine as best it can the economic implications of the rule.” *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005)).

If the Commission anticipates that the Proposed Rules will apply to the digital assets industry, then adopting the Proposed Rules would violate the Commission’s obligations under the Administrative Procedures Act (the “APA”) and the securities laws by failing to consider the rules’ impact on those participants. *Business Roundtable*, 647 F.3d at 1148; *Chamber of Commerce*, 412 F.3d at 143. SEC Staff guidance notes that “[d]efining the baseline typically involves identifying and describing the market(s) and participants affected by the proposed rule.”¹³ Nowhere does the Proposing Release assess the Proposed Rules’ scope and potential impact on the digital assets industry. Neither “digital assets” nor

¹¹ 15 U.S.C. § 78c(f). Proposing Release, 87 Fed. Reg. at 15,593 and note 796. Additionally, Section 23(a)(2) of the Exchange Act requires the Commission to consider the impact that any rule promulgated under the Act would have on competition and to include in the rule’s statement of basis and purpose “the reasons for the Commission’s . . . determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of [the Exchange Act].” 15 U.S.C. § 78w(a)(2).; see Proposing Release, 87 Fed. Reg. at 15,593 and note 796.

¹² See Proposing Release, 87 Fed. Reg. at 15,593.

¹³ Memorandum Re Currency Guidance on Economic Analysis in SEC Rulemakings at 7 (Mar. 16, 2012) (available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf).

“investment contracts” are mentioned anywhere in the Proposing Release, including in the baseline analysis or the cost-benefit analysis.¹⁴

The digital assets industry is left with concerns raised by a dissenting Commissioner and sparse text in a 591-page document. Technically, the dissent is not even part of the proposal. This violates the legal guarantee of fair notice and undermines the ability of the digital assets industry and the public to provide meaningful comment about the rule (which is already limited by the 30-day comment period).¹⁵

The Commission in the Proposing Release made no effort to evaluate which types of digital asset entities would fall within the proposed definition, how many of those types of entities would fall within the definition and what the costs would be for those digital asset entities to comply with the obligations created by the Proposed Rules. This stands in sharp contrast to the SEC’s extensive discussion of the current state of: (1) Communication Protocol Systems (87 Fed. Reg. at 15,594-595); (2) the Government Securities Market (id. at 15,595-15,603); (3) the Corporate Debt Market (id. at 15,603-607); (4) the Municipal Securities Market (id. at 15,607-610); (5) the Equity Market (id. at 15,610-615); (6) the Options Market (id. at 15,615-616); and (7) “Other Securities” such as Repurchase and Reverse Repurchase Agreements and Asset-Backed Securities (id. at 15,616-617).

Like it did with the various categories discussed above, the Commission in the Proposing Release should have made an initial assessment of what type and how many digital asset platforms are potentially affected by the Proposed Rules. The Proposing Release, however, is silent on this issue. The various examples and potential issues with the Proposing Release described on pages 9-11 of this comment letter are nowhere to be seen.

These deficiencies in the Proposing Release raise serious doubts as to whether any final rule purporting to apply the new definition of “exchange” to the digital assets industry would be a “logical outgrowth” of the Proposed Rules. “The requirement of notice and a fair opportunity to be heard is basic to administrative law.” *Chocolate Mfrs. Ass’n of U.S. v. Block*, 755 F.2d 1098, 1102 (4th Cir. 1985). Although the Commission “is not required to specify every precise proposal that it may eventually adopt as a rule,” a

¹⁴ The Commission’s proposing release covering its proposed redefinition of the term “dealer” at least mentions digital assets, albeit only once. See Release No. 34-94524, “Further Definition of ‘As a Part of a Regular Business’ in the Definition of Dealer and Government Securities Dealer” at note 36. In that rulemaking proceeding, the Commission also saw fit to offer the public 60 days, rather than 30, in which to comment.

¹⁵ The Commission’s wholesale disregard for the impact of the Proposed Rules on the digital assets industry cannot be mere oversight. The Commission and its Staff have not, to date, expressed any doubt as to potential “investment contract” implications of digital assets, and the SEC’s role in that connection. See, e.g., Framework for “Investment Contract” Analysis of Digital Assets, <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> (“[a] threshold issue is whether the digital asset is a ‘security’ . . . [t]he term ‘security’ includes an ‘investment contract’ and “[b]oth the Commission and the federal courts frequently use the ‘investment contract’ analysis to determine whether unique or novel instruments or arrangements, such as digital assets, are securities subject to the federal securities laws”); see also Digital Assets Risk Alert, <https://www.sec.gov/files/digital-assets-risk-alert.pdf> (“a number of activities related to the offer, sale, and trading of digital assets that are securities . . . present unique risks to investors”).

proposed rule must be “sufficiently descriptive to provide interested parties with a fair opportunity to comment and to participate in the rulemaking.” *Kennecott v. EPA*, 780 F.2d 445, 452 (4th Cir. 1985).

The digital asset industry is left to guess what the Commission thinks the Proposing Release will do regarding efficiency, competition and capital formation in the industry. As a result, the Commission has “entirely failed to consider an important aspect of the problem” in violation of its APA obligations. *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29, 43 (1983). Any attempt by the Commission to finalize a rule without first addressing these various issues, and giving the public an opportunity to comment on them, would similarly violate the APA. *See Chamber of Commerce v. SEC*, 443 F.3d 890, 904-05 (D.C. Cir. 2006).

If it was not the Commission’s intention for the Proposed Rules to apply to the digital assets industry, or if the Commission determines not to apply the Proposed Rules to the industry, then it should say so explicitly in the adopting release.

The proposed redefinition of “exchange” to cover “communication protocol systems” that make digital asset securities “available for trading” is overbroad and unworkable. If adopted, it will produce numerous negative second-order effects.

As noted above, the Commission has not yet authorized an exchange or an ATS to trade digital asset investment contracts — only tokenized equity (such as common stock and limited partner interests) and tokenized debt securities. There is no reason to expect that this will change. As a result, if the Proposed Rules are adopted and the digital assets industry is not exempted, then, pending litigation over the adopted rules, we believe that centralized platforms will either operate exclusively outside the United States or exit the business, knowing that there is no realistic prospect of obtaining SEC authority to operate as an exchange or SEC and FINRA authority to operate as an ATS.

That judgment will be informed by the failure of the Commission to authorize broker-dealers and ATSs to effectuate transactions in digital asset investment contracts, the failure of the Commission to recognize qualified custodians for digital assets, the failure of the Commission to facilitate digital asset transfer agents, and most of all the failure of the Commission to provide useful guidance about which digital assets are, and which are not, investment contracts and, therefore, securities. An analytical framework that includes more than thirty factors, none of which weighs more heavily than the others — and this is the essence of the FinHub Framework — is not a useful framework for making that determination.¹⁶

SEC-registered exchanges may trade only registered securities. Only a handful of digital assets have been registered with the Commission. We believe that virtually none will register in the future unless the Commission enables it. This is because the digital assets that trade in public markets are sufficiently

¹⁶ Where alternative regulatory frameworks are available under federal and state law, industry participants have engaged productively with the regulators. The Wyoming Banking Department, for example, has approved several “special purpose depositary institutions” to custody digital assets. The Office of the Comptroller of the Currency likewise has approved applications for digital asset custodial powers.

decentralized or otherwise excluded from United States securities regulation.¹⁷ Therefore, there is no business reason to register as an exchange if the assets targeted for listing are digital assets. If the Commission sincerely desires that digital asset platforms register as exchanges, then the Commission needs to find a way to allow those platforms to list digital assets.¹⁸

In addition, all registered exchanges are responsible for complying with a host of regulations that are not discussed at all in the Proposing Release as applied to investment contracts. Examples include record-keeping obligations, order book management, order trail, trade reporting, linkage to clearing, SRO responsibilities, compliance, reporting and disclosure. It appears that the Commission has not studied — and it certainly has not explained — how it will be possible for investment contract exchanges to operate in compliance with exchange regulations on these topics. Processing exchange applications in these circumstances would seem well-nigh impossible to us.

The Commission could potentially alter these rules to make them “fit” digital asset industry participants, but the Commission has not made that effort. In addition, exchange members must be registered broker-dealers. Very few persons that effect transactions only in investment contracts are registered as broker-dealers, and to our knowledge none is an exchange member. There are no models for this sort of business.

The experience and guidance that is lacking in investment contract exchange management and compliance is likewise missing in the ATS domain. As Chair Gensler is reported to have stated recently, most traditional ATSs cater to institutional investors trading equity or fixed-income products: “‘Thus, I’ve asked staff to consider whether and how the protections that are afforded to other investors on exchanges with which retail investors interact should apply to crypto platforms.’”¹⁹

We agree with Chair Gensler that these issues should be considered by the Staff, in consultation with the industry — and that is what should happen before (not after) any rules are proposed. As the Proposed Rules have not yet been adopted and have not yet been declared applicable to the digital asset industry, it is not too late for the SEC to study and consult with the industry and the CFTC about how exchange and ATS rules might be applied to platforms that trade what the SEC might seek to classify as investment contracts as well as non-security commodities.

Considering that no investment contract exchange or ATS currently exists, there is no model for investment contract exchange or ATS regulation compliance. Based on the experience to date, we believe

¹⁷ We are aware that the SEC Division of Enforcement, in its case against Ripple, is attempting to walk back public statements about the impact of decentralization made by former Chairman Jay Clayton and former Division of Corporation Finance Director William Hinman. The digital assets industry will continue to rely upon those statements nevertheless. The FinHub Framework was based upon those statements and is consistent with them even though it is not otherwise a useful analytical framework.

¹⁸ It seems that Chair Gensler “has asked the staff to consider how to regulate platforms where trading of securities and nonsecurities is entwined.” See Tom Zanki, “Gensler Tells Students Crypto Can’t Dodge Securities Laws,” Law360, April 4, 2022. We encourage Staff consideration of this scenario in consultation with industry representatives and the CFTC.

¹⁹ Id. (quoting Chair Gensler).

that attempted compliance by an investment contract market with the Commission's regulations cannot be achieved, resulting in massive investment losses by the public (estimated at \$2 trillion or more in digital asset market value). Forcing a multi-trillion-dollar loss on 40 million investors²⁰ is hardly in the public interest or for the protection of investors, nor is it good for the markets or for capital formation.

Exiting the business or operating exclusively outside the United States would seem to be the sensible business decision to make if the proposed rules are adopted, are made applicable to digital asset platforms, and are upheld by the courts. The economic losses that would be caused by failed attempts to comply with exchange and ATS regulations that do not "fit" are not accounted for in the Commission's rulemaking cost-benefit analysis, nor are the economic costs of exiting the business or moving entirely off-shore so as to lawfully avoid the Proposed Rules if adopted.

But that is not all that we believe you should consider. If adopted by the Commission and applied to the digital assets industry, the Proposed Rules will have numerous other negative second-order effects, such as these:

- The trading desk of a GDCA member communicates with virtually every *contra* party and customer via Telegram. Trading terms are confirmed via Telegram. Under the Proposed Rules, is this firm an "exchange"? Is Telegram an "exchange"? Should the firm and its *contra* parties and customers avoid Telegram in the conduct of their business? The Proposing Release does not discuss these issues. The Commission does not seem to have considered them.
- Telegram, Discord, Bloomberg, WhatsApp, Slack, Google, Facebook, and Zoom are communication protocol systems that provide their participants the means and protocols to interact, negotiate and come to an agreement²¹ — although that is not their purpose or their primary function. Are they therefore "exchanges" as proposed to be redefined? We do not know and we cannot determine the answer reliably. In this connection, the Commission seems to believe that communication protocols are either useful and used for trading purposes or else are useful and used for other purposes.²² That premise is false, however, because communication protocols are

²⁰ In its FACT SHEET, *supra* note 8, the White House pointed out that "around 16 percent of adult Americans — approximately 40 million people — have invested in, traded, or used cryptocurrencies."

²¹ See Proposing Release, 87 Fed. Reg. at 15504.

²² See *id.* at 15507-08, where the Commission states: "[A] system that displays trading interest and provides only connectivity among participants without providing a trading facility to match orders or providing protocols for participants to communicate and interact would not meet the criteria of Rule 3b-16(a) because such system would not be considered to be making available established, non-discretionary methods. For example, systems that only provide general connectivity for persons to communicate without protocols, such as utilities or electronic web chat providers, would not fall within the communication protocols prong of the proposed rule because such providers are not specifically designed to bring together buyers and seller of securities or provide procedures or parameters for buyers and sellers for securities to interact. To the extent that such systems are designed for securities and provide communication protocols for buyers and sellers to interact and agree to the terms of a trade, such systems would fall within the criteria of Exchange Act Rule 3b-16(a) as proposed to be revised." We believe this passage betrays a misunderstanding of the functionality and usage of services such as Telegram, Discourse and the others identified above. These services do not "only" provide general connectivity for communication unrelated to trading. They do

not binary: A protocol with a primary social or business use unrelated to trading might be useful and used secondarily or incidentally for trading, as in the case of GDCA member use of Telegram mentioned immediately above.

- Another GDCA member facilitates communications among open-source blockchain technology protocol and application developers, on the one hand, and customers who also happen to be digital asset purchasers and sellers, on the other hand. It is not unusual for protocol and application customers also to be digital asset investors: This is indeed the defining characteristic of the Web3 economy.²³ The GDCA member that hosts this communication protocol does not intend to facilitate transactions in digital assets — it is a technology platform, not an investment platform — but it is inevitable that prospective purchasers will make contact with prospective sellers and will exchange indications of interest with them. The member is concerned that this inevitability means that the member might come within the definition of an “exchange” under the Proposed Rules, in which case it would more likely choose to exit the business. Is that the right legal conclusion, and is that business outcome desirable as a matter of United States federal securities law policy?
- The knock-on effects of the proposed rules as applied to digital assets are aggravated by use of the broadly defined new term “trading interest” in the Proposed Rules. Trading interest would include any non-firm indication of interest in buying or selling a security that identifies the security and either quantity, direction (buy or sell), or price. The breadth of this definition sweeps up dialogue that otherwise would be outside the rules, which is a problem in the case of “inadvertent” or “incidental” exchange activity as described immediately above.
- Wallet providers such as MetaMask and Coinbase Wallet could be classified as “exchanges” under the Proposed Rules. They are unequipped for that and the Proposed Rules will not fit them. The businesses and personnel that stand behind wallets view themselves, and are viewed in commerce, as technology providers, not financial institutions.
- Even crypto asset miners and validation node operators might be deemed “exchanges” under the Proposed Rules, or perhaps facilities of exchanges. They do not consider themselves to be exchange operators or exchange facilities. They are minor role-players in global, decentralized systems.
- Linkages to custody and settlement processes, which every registered exchange addresses, are not part of the operating protocols of digital asset Communication Protocol Systems. The Commission has provided no public guidance regarding how such a system could arrange for custody and settlement to the Commission’s satisfaction, in order to operate as an exchange. In this connection, we note that no existing registered securities exchange also functions as a registered clearing agency. Very few institutions are qualified custodians for digital assets.

enable buyers and sellers to interact and agree to the terms of a trade, but that is not their primary purpose. The services have multiple purposes and uses.

²³ As it is commonly said, if Web1 is “read-only” and Web2 is “read-write,” then Web3 is “read-write-own.”

- The Commission’s rules for exchanges and ATSs are even more problematic as applied to decentralized exchanges, known as “DEXes.” The Proposing Release refers to communication protocols as being a method that a group of persons can provide.²⁴ DEX services, however, are not provided by persons. DEXes do not have exchange officials or principals. They do not even have employees. Does this mean a DEX is not an “exchange”? Does the Commission mean to treat a DEX as a “facility” of an exchange, in which case there would be need to create or identify an exchange “operator”? None of these questions is explored in the Proposing Release, so the industry and the public can only speculate. The answers to these questions, however, affect every DEX and every person who buys or sells digital assets through a DEX if those assets are securities. Moreover, “custody” with reference to DEX trading invariably means “self-custody.” This does not fit the Commission’s model, under which all exchanges are centralized.

For the reasons stated above, we submit that the Proposed Rules are overbroad, unworkable and counter-productive as applied to investment contract platforms that would be required to register as exchanges or qualify as ATSs under the Proposed Rules.

The Commission is exceeding its statutory authority by either ignoring or attempting to abandon silently the settled meaning of the word “broker” in the Exchange Act. Even if the Commission has the authority to redefine the word “exchange,” its offering of the ATS as a less-intrusive option is not plausible for Communication Protocol Systems that do not “effect” trades.

The Commission’s powers are limited by statute. Although the Commission is empowered to promulgate rules to implement provisions of the Exchange Act, in doing so the Commission should not — indeed it cannot — ignore settled interpretations of statutory terms, such as “exchange,” “broker” and “dealer,” nor can the Commission reinterpret those statutory terms to suit its changing policy preferences without explaining what it is doing and what in its view justifies the changes.

In this connection, the statutory term “broker” requires the “effecting” of transactions in securities. The statutory term “dealer” requires “engagement” in “the business of buying and selling securities.” These requirements are embedded in the statute, so they cannot be dismissed easily. Specifically, Exchange Act Section 3(a)(4)(A) states that “[t]he term ‘broker’ means any person engaged in the business of effecting transactions in securities for the account of others.” Exchange Act Section 3(a)(5)(A) states that “[t]he term ‘dealer’ means any person engaged in the business of buying and selling securities [subject to certain exclusions] for such person’s own account through a broker or otherwise.”²⁵

Exchange Act Section 15(a) states that a “broker” (or “dealer”) may not use the jurisdictional means unless registered under subsection (b), which in turn states that a “broker or dealer” may be registered by filing the prescribed form. Form BD, which is the prescribed form, requires the applicant to check a box if filing to register as a broker-dealer under Section 15(b); no option exists to register as a broker-dealer if the applicant does not fit within those definitions (or within the definitions of a government securities broker or dealer).

²⁴ See Proposing Release, 87 Fed. Reg. at 15506 note 109.

²⁵ See notes 14 and 37 and accompanying text.

The Commission’s own instructional materials, guidance and precedents are consistent with these definitions of broker and dealer. In its January 2011 Study on Investment Advisers and Broker-Dealers, the Commission adopted the definitions quoted above as the settled basis for its regulation of broker-dealers.²⁶ In informational materials directed to investors, the Commission, explaining “who is required to register,”²⁷ pointed to Section 3(a)(4)(A) of the Exchange Act to introduce “who is a broker”²⁸ and to Section 3(a)(5)(A) to introduce “who is a dealer.”²⁹ The Commission noted that individuals or entities conducting business in each of these categories must “register with the SEC and join a ‘self-regulatory organization,’ or SRO.”³⁰ A Commission Compliance Guide similarly adopts the Exchange Act definition of “dealer.”³¹ And the Commission regularly takes action against individuals and entities for violations of these rules — countless times, the SEC has sanctioned persons for “effecting transactions” in securities without registering as a broker or dealer or associating with a registered broker or dealer.³²

Only a registered broker-dealer may qualify as an ATS.³³ In the Proposing Release, the Commission asserts that a Communication Protocol System that would be required to register as an exchange can instead opt to qualify as an ATS.³⁴ But this is not so if the system in question cannot register as a broker-dealer.

Arguably, the Commission could use statutory authority to relax the requirements of Regulation ATS and related broker-dealer regulations and forms so as to permit a person that does not “effect transactions” to qualify as an ATS. But the Commission has not done that in the Proposing Release. And even if it had the power to do that and had done it, the Commission would be ignoring and rejecting — without stating any

²⁶ See Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (January 2011) at 46 n. 195 (setting forth the definitions in Exchange Act Sections (3)(a)(4)(A) and (3)(a)(5)(A) to articulate what constitutes a “broker” or a “dealer” and noting that each must “register with the Commission, absent an exception or exemption.”).

²⁷ See Investor Publication, Guide to Broker-Dealer Registration, <https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html>, at Section II.

²⁸ Id. at Section II.A.

²⁹ Id. at Section II.B.

³⁰ Id.

³¹ See Staff Compliance Guide to Banks on Dealer Statutory Exceptions and Rules, <https://www.sec.gov/divisions/marketreg/bankdealerguide.htm> (posing the rhetorical question “what is a dealer under the federal securities laws” and referring to Exchange Act Section (3)(a)(5)).

³² This year alone, see *In the Matter of Stephen Kenneth Grossman*, 2022 SEC Lexis 812 (March 30, 2022) (permanent bar by consent); *In the Matter of Cody C. Biggs*, 2022 SEC Lexis 166 (Jan. 21, 2022) (two-year bar by consent); *In the Matter of Benjamin D. Williams*, 2022 SEC Lexis 165 (Jan. 21, 2022) (three-year bar by consent); *In the Matter of Stephen Scott Moleski*, 2022 SEC Lexis 27 (Jan. 7, 2022) (order instituting proceedings).

³³ See Exchange Act Rule 301(b)(1) of Regulation ATS: “The alternative trading system shall register as a broker-dealer under section 15 of the [Exchange] Act.”

³⁴ See, e.g., Proposing Release, 87 Fed. Reg. at 15508 (text accompanying note 121).

justification or explanation for its behavior — decades of judicial and administrative interpretations about what it means to be a “broker.” The Commission would be creating considerable uncertainty throughout the securities industry about what it means to be a broker, which has always been understood to require the effectuation of transactions (order execution).

We believe that many Communication Protocol Systems are neither “brokers” nor “dealers” as defined by the Exchange Act because they do not effect securities transactions and do not engage in the business of buying and selling securities. For these systems, the option to qualify as an ATS is not available under current law, despite what the Proposing Release says. Nor can the Commission make that option available by expeditiously interpreting “broker” or “dealer” more broadly, because the limitations referred to above are found in the statute, not in the rules.

The consequence of “the ATS option” being unavailable to Communication Protocol Systems is significant. If not otherwise exempt from the Proposed Rules, then they will either need to register as exchanges or else exit the business. Registration as an exchange is extraordinarily expensive and entails massive on-going compliance costs and expenses. (The Commission knows this, which is why it makes available the ATS alternative for equity securities and debt securities.) The Commission has never yet registered a digital asset platform as an exchange. For these reasons, the more likely results are that platforms not exempted from the rules will either (1) choose to operate entirely outside the United States or (2) exit the business. The results also would include massive economic losses to the 40 million Americans who are invested in this \$2 trillion sector of the economy. These results would be inconsistent with the Commission’s statutory mandate, which includes facilitation of capital formation as one of its goals.

Alternatives to Adoption of the Package of Proposed Rules

There are options that the Commission could exercise that would be more appropriate than adopting the Proposed Rules as applied to “all securities.”

One option would be to adopt the Proposed Rules only with respect to equity securities, Treasury securities and fixed income securities and make it clear in the adopting release that the rules do not apply to other securities. This is the best option. Very little is said about “other securities” in the Proposing Release, and, again, nothing whatsoever is said about investment contracts or digital assets. The Proposing Release reads as if “other securities” were added to the coverage of the Proposed Rules at a late stage of preparation. We respectfully suggest that the Commission adhere to its original plan and, if it wishes to adopt the Proposed Rules, that it do so with respect to equity securities, Treasuries and fixed income securities only.

Alternatively, the Commission could adopt the Proposed Rules except for the expanded “exchange” definition. Although our comments focus on the impacts of the Proposed Rules on digital assets industry participants, our stated concerns would support this more cautious rulemaking approach regarding other kinds of securities.

A third option would be the possibility of adopting the Proposed Rules as to all securities other than “investment contracts,” as those are the types of securities that the Commission usually points to in its

enforcement actions as including the digital assets in question.³⁵ If the Commission desires to engage in rulemaking relative to investment contract digital assets, which we would welcome, then the Commission should formulate one or more rulemaking projects directly addressing the digital assets industry, should add those work streams to its “Reg Flex” agenda, and should pursue them in the ordinary course of Commission business.³⁶

In this connection we are mindful that the Commission also is proposing to redefine the term “dealer” to include proprietary trading firms and specified other market participants in certain circumstances.³⁷ This letter does not address that proposal because the time allowed for this response by the Commission does not permit it, but we agree with Commissioner Peirce that the two rulemaking proposals overlap and beg joint analysis. Proposing rules piecemeal, when they are inter-related as these are, without allowing the industry to see the full picture and consider, then comment on, how they fit together, and what issues they raise, is inconsistent with the White House directive to work with other agencies, and with the digital assets industry, to study and support the development of the industry while mitigating risks.

Conclusion

Throughout its history, the Commission has been statesmanlike in addressing the workings of exchanges, and wisely so, because of the systemic importance of exchanges and because of the complex relationships among market participants relative to exchanges. When faced with substantial changes to market structure, including those wrought by new technology, the approach of the Commission and Congress has been altogether more thoughtful than we perceive in the Proposing Release relative to investment contracts.³⁸

We are addressing a rulemaking proposal with profound implications for the digital asset industry and the 40 million Americans who have bought digital assets. Like many others, we asked the Commission to allow more time for comment.³⁹ Again we agree with Commissioner Peirce, who has highlighted and illustrated the prudence of gathering information about possible negative second-order and third-order

³⁵ We note this Commission enforcement position while we take no position on whether any particular digital asset is a security. It is beyond dispute, however, that the overwhelming majority of digital asset trading volume in spot markets today is in commodities and not securities. See Letter dated January 12, 2022 to CFTC Chairman Behman from Senators Debbie Stabenow and John Boozman and Representatives David Scott and Glenn “GT” Thompson, <https://www.agriculture.senate.gov/imo/media/doc/FINAL%20Digital%20Assets%20Letter%202022-01-12.pdf>.

³⁶ Ancillary to this, the Commission could propose a time-limited Securities Act registration exemption for digital assets such as Securities Act Rule 195, proposed by Commissioner Peirce, see “Token Safe Harbor Proposal 2.0” (April 13, 2021), <https://www.sec.gov/news/public-statement/peirce-statement-token-safe-harbor-proposal-2.0>, or Representative McHenry’s proposed exemption inspired by her, see H.R. 5496, 117th Congress (2021-2022), “Clarity for Digital Tokens Act of 2021,” at <https://www.congress.gov/bill/117th-congress/house-bill/5496/text>.

³⁷ See note 14 supra.

³⁸ Again, we have no comment on the Proposed Rules as they relate to Treasury and fixed income securities.

³⁹ See Letter dated Feb. 2, 2022 from Renata K. Szkoda, Chair, Global Digital Asset & Cryptocurrency Association, et al., to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, at <https://www.sec.gov/comments/s7-02-22/s70222-20113579-265850.pdf>.

effects otherwise caused by hasty decisions made with the best of intentions.⁴⁰ The President in his Executive Order has instructed his administration to collaborate with one another and to act prudently when touching upon digital assets so as to avoid harming business, including the \$2 trillion digital assets industry that in the President's view holds promise.

The President has instructed his administration to work “with the private sector to study and support technological advances in digital assets.”⁴¹ Adopting the Proposed Rules without more and without exempting digital assets would destroy, not “support,” “technological advances in digital assets,” while excluding “private sector” leadership from the process and without even “studying” the industry or the impact. In short, that course of action would ignore the spirit and desire of the Executive Order.

For all the reasons stated in this letter, we respectfully ask the Commission to slow down and study the possible impacts of the Proposed Rules on the digital assets ecosystem (especially the retail investors who engage in it) before extending the scope of its regulatory net so broadly. We do not believe that the Proposed Rules can be implemented by investment contract exchanges or investment contract ATSs absent significant concurrent rulemaking and interpretive guidance that has not been forthcoming from the Commission or the Staff.

Forcing exchange registration on an industry, public and Staff that are unprepared for it would cause massive economic damage.

Accordingly, we urge you to consider the alternatives that we have proposed and to pursue one of them rather than adopt the Proposed Rules and attempt to make them fit the digital assets industry.

Respectfully submitted,



Renata K. Szkoda
Chair

Drafting Committee:

Chair – Patrick Daugherty, Esq. (Foley & Lardner)
Jason Allegrante, Esq. (Fireblocks)
Kristin Boggiano, Esq. (CrossTower Exchange)
Carla Carriveau, Esq. (CoinList)
Katherine Cooper, Esq. (McGonigle, P.C.)
Daniel J. Davis, Esq. (Katten)

⁴⁰ See Commissioner Hester M. Peirce, “Rat Farms and Rule Comments – Statement on Comment Period Lengths” (December 10, 2021), available at <https://www.sec.gov/news/statement/peirce-rat-farms-and-rule-comments-121021>.

⁴¹ See FACT SHEET, *supra* note 8.

Erika Harford, Esq. (Anchorage Digital)
Harris Kay, Esq. (McGonigle, P.C.)
Steven Lofchie, Esq. (Fried Frank)
Ida Mok, Esq. (Fluidity Money)
Georgia Quinn, Esq. (Anchorage Digital)
Lee A. Schneider, Esq. (Ava Labs)
Damien G. Scott, Esq. (CoinList)
Kathryn Trkla, Esq. (Foley & Lardner)
Nicole Trudeau, Esq. (CEX)
William Walsh (McGonigle, P.C.)

Additional Signatories:

Nisa Amoils, Esq.
Managing Partner
A100x Ventures

Georgia Quinn
General Counsel
Anchorage Digital

Jeanine Hightower-Sellitto
CEO
Atomyze LLC

Lance Morginn
President
Blockchain Intelligence Group

David H. Brill, Esq.

Nicole Trudeau
General Counsel
CEX.IO Corp.

Damien G. Scott
Deputy General Counsel
CoinList

David Weisberger
Co-Founder and CEO
Coinroutes LLC

Monica Singer
Senior Strategy
Consensys

Michael Frisch
Partner
Croke Fairchild Morgan & Beres

Kristin Boggiano
Co-founder & President
CrossTower

Kian Sarreshteh
CEO
CryptoFi

Paul McCarthy
CEO
Chrysalis DAE

Ida Mok
Chief Legal Officer
Fluid Assets Pty Ltd

Jamil Hasan
Individual Member
Global DCA

Tony Pettipiece
Chairman of the Board
GRIP (DIFC) Investments

Lance Baker
COO
Lootverse.com (Loot NFT Co LLC)

Michael C. Mitchell
Founder and CEO
MCM Group International Inc.

Adam Carlton
CEO
Pink Panda Holdings, Inc.

Ruby G. Sekhon
Chief Legal Officer and Chief Compliance Officer
Polychain Capital LP

Nilesh Sudrania
Founder & CEO
Sudrania Fund Service Corporation

Calvin Carter
CEO
Talon Labs, LLC

Andrew Strasman
Principal
Totem Asset Group

Raymond Salvatore
Co-Founder
Traders Fulcrum

Nicole Trudeau, Esq.

James L. Koutoulas
Chief Executive Officer
Typhon Capital Management

Joel Quall
Chief Financial Officer
tZERO Group, Inc.

Jeffrey Carter
General Partner
West Loop Ventures

cc: Joseph Biden, President of the United States
Steven Richetti, Counselor to the President of the United States
Brian Deese, Director, National Economic Council of the United States
Gina Raimondo, Secretary of the Department of Commerce
Honorable Gary Gensler
Honorable Hester M. Peirce
Honorable Allison Herren Lee
Honorable Caroline A. Crenshaw
Honorable Rostin Behnam
Daniel Berkovitz, Esq. (SEC General Counsel)

Professor Haoxiang Zhu (Director, SEC Division of Trading and Markets)
Renee Jones, Esq. (Director, SEC Division of Corporation Finance)